



Report to Council

24 OCTOBER 2012

LEADER
*Councillor Nicholas
Botterill*

TREASURY MANAGEMENT OUTTURN REPORT

Wards:
All

This report provides information on the Council's debt, borrowing and investment activity for the financial year ending 31 March 2012.

CONTRIBUTORS

EDFCG
DoL

RECOMMENDATIONS:

- 1. To note that the Council has not undertaken any borrowing for the period 1 April 2011 to 31 March 2012.**
- 2. To note the investment activity for the period 1 April 2011 to 31 March 2012.**

1. INTRODUCTION AND BACKGROUND

- 1.1 This report presents the Council's Annual Treasury Report for 2011/12 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to the Cabinet by 30 September each year.
- 1.2 There are two aspects of Treasury performance – debt management and cash investments. Debt management relates to the Council's borrowing and cash investments to the investment of surplus cash balances. This report covers:
- The treasury position as at 31 March 2012
 - The UK economy and interest rates
 - Investment strategy and outturn for 2011/12
 - The borrowing strategy and outturn for 2011/12
 - Compliance with treasury limits and prudential indicators
- 1.3 The borrowing amounts outstanding and cash investment for the relevant periods are as follows:

Table 1 – Balances

	31/03/12	31/03/11	31/03/10
	£'000	£'000	£'000
Total borrowing	262,166	475,520	475,520
Total cash balances	109,300	70,000	137,000

2. TREASURY POSITION AS AT 31 MARCH 2012

2.1 Investments

The table below provides a breakdown of the cash deposits, together with comparisons from the previous year.

Table 2 – Investments

Investment Type	31 March 2012	31 March 2011
	£000's	£000's
Call Account	18,800	30,000
Term Deposits	69,500	10,400
Money Market Funds	21,000	30,000
Total	109,300	70,400

- 2.2 The Council had invested in four money markets funds during 2011-12 Prime Rate, Goldman Sachs, Insight and Blackrock producing returns ranging from 0.55 to 0.96%, all are AAA rated.
- 2.3 The term deposits ranged from overnight to 1 year. The weighted average interest rate of return on the investments over the year was 1.18%.

3. BORROWING

3.1 Treasury Borrowing

No new borrowing was undertaken during the year. PWLB debt maturing during the year, which was not refinanced, totalled £16 million, with an average nominal interest rate of 9.84%. This resulted in a reduction in the average PWLB borrowing rate from 5.70% to 5.61%.

3.2 An analysis of movements on loans during the period is shown below:

Table 3 – Movement on loans

	Balance 31.03.11 £000s	Loans/Invs Raised £000s	Loans/Invs Repaid £000s	Balance 31.03.12 £000s
PWLB	475,520	0	(16,000)	
PWLB HRA settlement			(197,354)	
Total debt	<u>475,520</u>	<u>0</u>	<u>(213,354)</u>	<u>262,166</u>

Table 4 – Outstanding Debt

	31 March 2011		31 March 2012	
	Principal	Average Rate	Principal	Average Rate
	£000's		£000's	
PWLB General Fund	60,993		44,785	
PWLB HRA	414,527		217,381	
Total	475,520	5.70%	262,166	5.61%

3.3 The implementation of housing finance reform at the end of the year abolished the housing subsidy system financed by central government and consequently all housing debt has been reallocated nationally between housing authorities. The result of this reallocation is that this Council received, at the end of the year, a repayment of debt by the Department of Communities and Local Government of £197.35 million (which resulted in a corresponding decrease in its HRA CFR). The CLG has also paid the premium (breakage costs) of £53.99 million.

Table 5 – Capital Financing Requirement (CFR)

	31 March 2011 Actual £'000	31 March 2012 Budget £'000	31 March 2012 Actual £'000
CFR General Fund	121,768	111,679	99,684
CFR HRA	414,527	217,427	217,381
Total CFR	536,295	329,106	317,065

- 3.4 The CFR represents the underlying borrowing need of the HRA and General Fund. The reason why actual borrowing is lower than the CFR is because the Council has effectively borrowed from its internal resources.

4. THE ECONOMY AND INTEREST RATES

- 4.1 **Sovereign debt crisis.** 2011-12 was the year when financial markets were apprehensive, fearful of the potential of another Lehman's type financial crisis, prompted by a precipitous Greek Government debt default. At almost the last hour, the European Central Bank (ECB) calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two huge three year credit lines, totalling close to €1 trillion at 1%. This also provided a major incentive for those same banks to then use this new liquidity to buy EU sovereign debt yielding considerably more than 1%.
- 4.2 A secondary benefit of this initiative was the bringing down of sovereign debt yields, for the likes of Italy and Spain, below unsustainable levels. The final aspects in the calming of the EU sovereign debt crisis were two eleventh hour agreements: one by the Greek Government of another major austerity package and the second, by private creditors, of a "haircut" (discount) on the value of Greek debt that they held, resulting in a major reduction in the total outstanding level of Greek debt. These agreements were a prerequisite for a second EU / IMF bailout package for Greece which was signed off in March.
- 4.3 Despite this second bailout, major concerns remain that these measures were merely a postponement of the debt crisis, rather than a solution, as they did not address the problem of low growth and loss of competitiveness in not only Greece but also in other EU countries with major debt imbalances. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the new Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.
- 4.4 The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year.

- 4.5 **UK growth** proved mixed over the year. In quarter 2, GDP growth was zero, from the major western central banks: the US economy was flat but then quarter 3 surprised with a return to robust growth of 0.6% q/q before moving back into negative territory (-0.3%) in quarter 4. The year finished with prospects for the UK economy being decidedly downbeat due to a return to negative growth in the EU in quarter 4, our largest trading partner, and a sharp increase in world oil prices caused by Middle East concerns. However, there was also a return of some economic optimism for growth outside the EU and a third dose of quantitative easing to boost growth.
- 4.6 **UK CPI inflation** started the year at 4.5% and peaked at 5.2% in September. The fall out of the January 2011 VAT increase from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, finishing at 3.5% in March. Inflation is forecast to be on a downward trend to below 2% over the next year.
- 4.7 The Monetary Policy Committee agreed an increase in quantitative easing (QE) of £75bn in October on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. The MPC then agreed another round of £50bn of QE in February 2012 to counter the negative impact of the EU debt and growth crisis on the UK.
- 4.8 **Gilt yields** fell with the **Bank Rate** unchanged at 0.5% throughout the year. Expectations of when the first increase would occur were steadily pushed back until the second half of 2013 at the earliest. Deposit rates picked up in the second half of the year as competition for cash increased among banks.
- 4.9 **Risk premiums** were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the credit ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

5. INVESTMENT STRATEGY AND OUTTURN FOR 2011/12

- 5.1 The investment strategy for 2011/12 was to place cash investments with certain institutions as set out in the Treasury Management Strategy, to focus on the security and liquidity of the investments rather than to seek yield. Where security and liquidity criteria could be satisfied, investments would then be placed taking yield into account.
- 5.2 The investments outstanding at 31 March 2012 amounted to £109.3 million: £18.8 million was invested in NatWest Call Account, £21 million invested in 3 money Market Funds, £10 million with a Local Authority and £59.5 million invested in short term deposits.

Table 6 – Investment Portfolio as at 31 March 2012

Deposit	Counterparty	£'000
Call Account	NatWest	18,800
Money Market Funds	Goldman Sachs	1,000
	Insight	10,000
	Primerate	10,000
Term Deposits	DMADF	4,500
	LloydsTSB	35,000
	NatWest	15,000
	Birmingham City Council	10,000
	Barclays Bank	5,000

5.3 Interest earnings for 2011/12 were £1.20 million compared to £1.19 million for 2010/11.

5.4 An analysis of movements on investments during 2011/12 is shown below.

Table 7 – Movement on Investments

	Balance 31.03.11 £000s	Loans/Invs Raised £000s	Loans/Invs Repaid £000s	Balance 31.03.12 £000s
Investments	70,400	1,021,600	(982,700)	109,300

6. BORROWING STRATEGY AND OUTTURN 2011/12

6.1 The treasury strategy for 2011-12, approved by the Council on 23 February 2011, was based on the expectation that base rate, whilst remaining low, would rise gradually from the fourth quarter of 2011 with similar gradual rises in medium and longer term fixed interest rates over 2011-12. Continued uncertainty in the aftermath of the 2008 financial crisis led to a continuation of a cautious approach for investments with low counterparty risk the main consideration, resulting in relatively low returns compared to borrowing rates.

6.2 Due to the level of cash balances held by the Council of £70.4 million at 31 March 2011, it was anticipated that there would not be any need to borrow during 2011/12.

6.3 An analysis of the Council's long term (PWLB) borrowings by maturity (i.e. date of repayment) is as follows:

Table 8 – PWLB Debt by maturity

PWLB	31 March 2011 £000s	31 March 2012 £000s
Up to One year	16,000	100
One to two years	175	11,556
Between two and five years	52,881	18,614
Between five and ten years	70,400	40,164
More than ten years	<u>336,064</u>	<u>191,732</u>
Total	<u>475,520</u>	<u>262,166</u>

7. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

During the financial year the Council operated within its treasury limits and Prudential Indicators as set out in the Council's Treasury Strategy Report.

Table 9 – Authorised Limit and Operational Boundary 11/12

External debt indicator	Approved limit (£m)	Actual borrowing	Days exceeded
Authorised limit ¹	364		
Operational boundary ²	303	262	None

Table 10 – Maturity Structure of Borrowing

Maturity structure of borrowing	Lower Limits (%)	Upper Limits (%)	Actual at 31 March 2012 (%)
Under 12 months	0	15	0.04
1-2 years	0	15	4.41
2-5 years	0	60	9.80
5-10 years	0	75	12.62
10 years and over	0	100	73.13

Table 11 – Limits on interest rate exposure

Upper limits on interest rate exposure	Approved maximum limit	Actuals as at 31 March 2012
Debt		
Fixed interest rate exposures	330,000	262,166
Variable interest rate exposures	66,000	0

¹ Authorised limit for external debt is the limit above which external debt must not go without changing Council Policy

² Operational boundary for external debt is the limit against which external debt will be constantly monitored.

8. COMMENTS OF THE EXECUTIVE DIRECTOR OF FINANCE AND CORPORATE GOVERNANCE

8.1 These are contained within this report.

9. COMMENTS OF THE DIRECTOR OF LAW

9.1 There are no direct legal implications for the purpose of this report.

10. RECOMMENDATIONS

10.1 To note the borrowing and investment activity for the period 1 April 2011 to 31 March 2012.

LOCAL GOVERNMENT ACT 2000
BACKGROUND PAPERS

No.	Brief Description of Background Papers	Name/Ext. of holder of file/copy	Department/Location
1.	Loans and Investments Ledger	Rosie Watson Ext: 2563	Westminster City Hall, Treasury and Pensions Team 16 th Floor,
2.	CIPFA Treasury Management Code of Practice	Rosie Watson Ext: 2563	Westminster City Hall, Treasury and Pensions Team 16 th Floor,